



NORTHSTAR AEROSPACE, INC.

CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2009 and 2008 and

For the three and nine months ended September 30, 2009 and 2008



Consolidated Balance Sheets
(in thousands of U.S. dollars)
UNAUDITED

	September 30	December 31
	2009	2008
		Restated (note 2)
ASSETS		
Accounts receivable, net	\$ 21,260	\$ 27,093
Inventories, net (notes 2 and 4a)	67,262	59,262
Other current assets	1,681	12,747
Discontinued operations (note 7)	-	7,233
Total current assets	90,203	106,335
Property, plant and equipment, net	42,737	42,348
Goodwill, net	2,436	2,436
Other long-term assets (note 4b)	11,017	12,351
Discontinued operations (note 7)	-	4,738
Total assets	\$ 146,393	\$ 168,208
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable and accrued liabilities (note 2)	\$ 29,330	\$ 26,718
Other current liabilities (notes 2 and 4c)	17,341	21,807
Current portion of long-term debt (note 4e)	3,257	27,196
Current portion of other long-term liabilities (note 4d)	5,159	2,717
Discontinued operations (note 7)	-	2,529
Total current liabilities	55,087	80,967
Long-term debt (note 4e)	46,590	43,180
Other long-term liabilities (notes 4d and 9)	21,446	19,752
Discontinued operations (note 7)	-	1,059
Total liabilities	123,123	144,958
Shareholders' equity	23,270	23,250
Total liabilities and shareholders' equity	\$ 146,393	\$ 168,208

Going concern (note 1)

To be read in conjunction with notes to interim consolidated financial statements.



Consolidated Statements of Operations

(in thousands of U.S. dollars except share and per share amounts)

UNAUDITED

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
REVENUE, net of revenue share amortization and costs (note 5)	\$ 48,098	\$ 40,025	\$ 140,202	\$ 120,117
Cost of sales and expenses				
Cost of sales, excluding depreciation and amortization	38,086	32,921	111,480	96,780
Selling, general and administration	4,908	4,464	14,900	12,554
Foreign exchange loss (gain)	338	(174)	554	(666)
Depreciation and amortization	1,578	1,731	4,987	5,218
Unusual items (note 8)	-	-	(1,855)	-
Interest, net	1,949	1,561	4,858	4,764
Write off of deferred financing costs	-	-	309	-
(Gain) loss on interest rate swap contracts	(59)	24	1,045	85
Income (loss) before income taxes from continuing operations	1,298	(502)	3,924	1,382
Income tax expense (recovery) (note 4f)	1,709	(752)	3,233	963
Net (loss) income, continuing operations	(411)	250	691	419
Discontinued operations, net of taxes (note 7)	-	54	(852)	594
Net (loss) income	\$ (411)	\$ 304	\$ (161)	\$ 1,013

Net (loss) income per common share (note 4g)

Basic				
Continuing operations	\$ (0.01)	\$ 0.01	\$ 0.02	\$ 0.01
Discontinued operations	-	0.00	(0.03)	0.02
	\$ (0.01)	\$ 0.01	\$ (0.01)	\$ 0.03
Diluted				
Continuing operations	\$ (0.01)	\$ 0.01	\$ 0.02	\$ 0.01
Discontinued operations	-	0.00	(0.03)	0.02
	\$ (0.01)	\$ 0.01	\$ (0.01)	\$ 0.03

Weighted average number of shares

Basic	29,880,318	29,880,318	29,880,318	29,875,024
Diluted	29,880,318	29,880,318	29,880,318	29,875,024

To be read in conjunction with notes to interim consolidated financial statements.



Consolidated Statements of Comprehensive Income (Loss)

(in thousands of U.S. dollars)

UNAUDITED

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net (loss) income for the period	\$ (411)	\$ 304	\$ (161)	\$ 1,013
Other comprehensive income (loss), net of tax:				
Currency translation adjustment	1,556	(889)	2,779	(2,050)
Available for sale assets (note 8)	-	(2,348)	(4,448)	2,663
Income tax benefit (expense)	-	370	734	(370)
	-	(1,978)	(3,714)	2,293
Derivatives designated as cash flow hedges (note 4c)	-	7	1,569	(14)
Income tax (expense) benefit	-	(3)	(608)	5
	-	4	961	(9)
Total other comprehensive income (loss)	1,556	(2,863)	26	234
Comprehensive income (loss)	\$ 1,145	\$ (2,559)	\$ (135)	\$ 1,247

Consolidated Statements of Shareholders' Equity

For the nine months ended September 30, 2009 and 2008

(in thousands of U.S. dollars, except share amounts)

UNAUDITED

	Number of Shares	Capital Stock	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income (note 6)	Total
Balance December 31, 2008	29,880,318	\$ 108,048	\$ 817	\$ (92,100)	\$ 6,485	\$ 23,250
Other comprehensive income	-	-	-	-	26	26
Stock compensation expense	-	-	155	-	-	155
Net loss for the period	-	-	-	(161)	-	(161)
Balance September 30, 2009	29,880,318	\$ 108,048	\$ 972	\$ (92,261)	\$ 6,511	\$ 23,270
Balance December 31, 2007, as restated	29,720,318	\$ 107,131	\$ 793	\$ (82,686)	\$ 19,257	\$ 44,495
Options exercised	160,000	602	(205)	-	-	397
Other comprehensive income	-	-	-	-	234	234
Stock compensation expense	-	-	222	-	-	222
Net income for the period	-	-	-	1,013	-	1,013
Balance September 30, 2008, as restated	29,880,318	\$ 107,733	\$ 810	\$ (81,673)	\$ 19,491	\$ 46,361

To be read in conjunction with notes to interim consolidated financial statements.



Consolidated Statements of Cash Flows

(in thousands of U.S. dollars)

UNAUDITED

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Cash provided by (used in):				
Operating Activities				
Net (loss) income from continuing operations	\$ (411)	\$ 250	\$ 691	\$ 419
Items not affecting cash:				
Depreciation and amortization	1,578	1,731	4,987	5,218
Amortization of revenue sharing agreement (note 5)	539	1,010	3,667	2,876
Stock compensation expense	42	73	155	222
Pension and post-retirement benefits	1	(423)	(15)	(708)
Sale of investment in Vector	-	-	(5,990)	-
Litigation settlement (note 8)	-	-	4,135	-
Future income taxes	471	652	1,273	15
Foreign exchange loss (gain)	338	(174)	554	(666)
Write off of deferred financing costs	-	-	309	-
(Gain) loss on interest rate swap contracts	(59)	24	1,045	85
Non-cash interest expense	95	46	187	144
	2,594	3,189	10,998	7,605
Net change in non-cash working capital balances related to continuing operations (note 4i)	(4,041)	4,978	(2,365)	4,341
	(1,447)	8,167	8,633	11,946
Cash provided by (used in) discontinued operations (note 7)	-	2,621	(1,350)	3,158
Cash (used in) provided by operating activities	(1,447)	10,788	7,283	15,104
Investing Activities				
Proceeds on sale of investment in Vector, net	-	-	11,272	-
Proceeds on sale of discontinued operations, net	849	-	8,333	-
Capital expenditures, net	(1,109)	(678)	(3,536)	(1,900)
Discontinued operations (note 7)	-	(328)	395	(2,127)
Cash (used in) provided by investing activities	(260)	(1,006)	16,464	(4,027)
Financing Activities				
Common shares issued	-	-	-	397
Long-term debt borrowing	1,707	-	3,686	335
Long-term debt repayments	-	(9,782)	(25,172)	(11,809)
Settlement of interest rate swap contract	-	-	(590)	-
Financing fees paid	-	-	(383)	-
Discontinued operations (note 7)	-	-	(1,288)	-
Cash provided by (used in) financing activities	1,707	(9,782)	(23,747)	(11,077)
Change in cash during the period	-	-	-	-
Cash at beginning of period	-	-	-	-
Cash at end of period	\$ -	\$ -	\$ -	\$ -

To be read in conjunction with notes to interim consolidated financial statements.

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

1. BASIS OF PRESENTATION – GOING CONCERN

These unaudited interim consolidated financial statements have been prepared using Canadian generally accepted accounting principles consistent with those in the most recent audited consolidated financial statements except for the new accounting pronouncements which have been adopted effective January 1, 2009 as described in note 3. The principles used are those applicable to a going concern which contemplates the realization of assets and the liquidation of liabilities in the normal course of business. The use of such principles may be inappropriate as at September 30, 2009 because of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern. The Company has incurred significant losses from 2006 through 2008, attributable to operations, provisions for restructurings and charges related to the environmental remediation at the Company's Canadian subsidiary. Over these years, the losses incurred have resulted in violations of the Company's credit agreements. The most recent violations at September and December 2008 were at a time when the global credit market crisis made the availability of funds more limited and the required financial performance metrics for accessing those funds more difficult to achieve.

As discussed in note 4e, the Company obtained an amendment to its existing credit facility in December 2008 to resolve the covenant violation at September 2008. That amendment required a total of \$25,000 of debt reduction by April 30, 2009. In January 2009, the Company sold its investment in Vector Aerospace Corporation and used the proceeds to fund a repayment of debt of \$11,715. In March 2009, the Company was able to repay an additional \$5,000 through the realization of proceeds from General Electric Aviation's ("GEA") sale of the Company's spare parts inventory related to the CF34-3 program that was held on consignment at one of GEA's locations.

In March 2009, the Company received an amendment that reduced the maximum available borrowings of the credit facility to \$57,500 and moved the remaining requirement of a \$7,500 debt repayment to July 31, 2009. In May 2009, the Company completed the sale of the assets and certain liabilities of a subsidiary (Note 7). The proceeds from this transaction were used to satisfy the remaining debt repayment requirement. With this payment, the maximum available borrowings were reduced to \$50,000.

The terms of the March 2009 amendment include moving the maturity date of the loan from March 2012 to October 1, 2010. The Company's ability to maintain compliance with the terms of the agreement is essential to the Company's ability to continue as a going concern. The amendment revised the covenants to be in line with management's 2009 operating plan. The Company's ability to meet these covenants is dependent on the Company's ability to realize its 2009 and 2010 operating plans. The Company is subject to significant risks in achieving these plans. These risks include the following:

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

- **Concentration of Revenue** – The Company’s revenue is derived from a limited number of customers. Revenues attributable to the largest five customers were 81.9% and 81.8% for the three months ended September 30, 2009 and 2008, respectively. Revenues attributable to the largest five customers were 80.5% and 80.0% for nine months ended September 30, 2009 and 2008, respectively. The decision by a key customer not to renew a long-term contract or cease to use the Company as a supplier may adversely impact the Company’s operating performance.
- **Delivery Changes under Long-Term Contracts** - The Company has long-term contracts to supply customers that typically contain estimates of shipment quantities. These contracts allow the customer to amend or cancel shipments under purchase order within certain notice periods. If customers adjust shipment requirements downward, revenues and cash flows will be negatively affected. A shift in the timing of delivery of these orders could adversely impact the Company’s ability to meet quarterly covenants of the credit agreement.
- **Reliance on a Cyclical Aerospace Industry** –The Company derives its revenues from defense and commercial businesses. Defense revenues are affected by government spending, defense strategies, security issues and political factors. The Company’s revenue is concentrated in the defense industry. Defense related revenues were 80.6% and 72.6% for the three months ended September 30, 2009 and 2008, respectively. Defense related revenues were 75.0% and 71.6% for the nine months ended September 30, 2009 and 2008, respectively. Commercial revenues are affected by economic conditions, flight safety, age of aircraft and new aircraft development. A significant change in any of these factors would impact the timing of customer delivery requirements and potentially the customer requirements in total.
- **Management of Business Growth** - A majority of the revenues and production from the Company’s largest customers for 2009 and 2010 is from orders already received. Revenues from continuing operations in the three and nine months ended September 30, 2009 compared to the same period in 2008 increased by 20.2% and 16.7%, respectively. The ability of the Company to manage this growth effectively will require it to continue to improve its operational and financial systems and to expand, train and manage its employee base. This will require continued compliance with the credit agreements and access to credit markets to appropriately finance growth.
- **Raw Material and Labor** - The Company purchases substantially all of its raw materials from third party qualified suppliers and manufacturers. The inability or refusal of a key qualified supplier to deliver required materials could result in a disruption of the Company’s operations and delays in meeting customer deadlines and contract requirements. The Company also depends on its ability to attract and retain a highly skilled workforce.

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

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- Currency - Revenues of the operations located in Canada are denominated in U.S. dollars, Canadian dollars and Pounds Sterling, while the labor and overhead expenses are denominated primarily in Canadian dollars. The unaudited interim consolidated financial revenues and results from operations are affected as a result of changes in exchange rates between these currencies. The significant variances realized in recent years have impacted the Company's earnings on specific contracts and the Company's reported net worth.

In addition to these economic and operational risks, the Company has exposure to the following risks to the Company's overall viability to continue as a going concern:

- Environmental – Between 2004 and 2007, the Company provided \$22,449 for estimated environmental testing and remediation costs in respect to environmental issues relating to the Cambridge, Ontario facility. As of September 30, 2009, the remaining provision is \$7,995. Management estimates that the remaining accrual is sufficient for such testing and remediation costs based on requirements through 2012. Additionally, another party has been identified as having some responsibility for the contamination. Management's estimate for remediation costs excludes the Company's responsibility for the area currently assumed to be the responsibility of this additional source. These estimates for remediation are based on a number of assumptions where no assurance can be given that the estimates will not differ from the actual costs based on environmental test results, changes in laws or enforcement policies, further determination of the level of responsibility of the Company or the additional source, or other factors.
- Litigation – The Company and its subsidiary Northstar Aerospace (Canada) Inc. (Northstar Canada) are defendants in claims related to environmental concerns noted above. In one claim, the plaintiffs are seeking general and punitive damages of Cdn \$213,200 for damages to health and property values. If successful, this claim and other unspecified litigation actions could involve significant damages which would have a significant adverse effect on the financial condition of the Company and the Company may not have the resources to be able to satisfy such claims.
- Ability to refinance – With the March 2009 amendment, the maturity date of the credit agreement has been accelerated to October 2010. The Company will require bank financing subsequent to that date. The Company's ability to obtain that financing is dependent on the Company's performance, as well as, the availability of funds in the credit markets. There can be no assurance that even if the Company meets its operating plan, that it will be able to obtain the financing necessary to continue as a going concern.

Notes to Consolidated Interim Financial Statements

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UNAUDITED

The Company's ability to continue as a going concern is dependent on many events, some of which are outside of the direct control of management, including the risks noted above. The significant recent losses and the resulting violations of bank covenants, among other factors, raise significant doubt as to the Company's ability to continue as a going concern. The unaudited interim consolidated financial statements do not include any adjustments in the carrying values of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used, that would be necessary if the Company were unable to realize its assets and discharge its liabilities as a going concern in the normal course of operations and such adjustments could be material.

2. RESTATEMENT OF CUSTOMER ADVANCES ON LONG-TERM CONTRACTS

On certain long-term production and development contracts, the Company is entitled to progress billings. The Company has determined that certain of these progress billings up through September 30, 2009 were received in advance of meeting the prescribed milestones, and accordingly, \$14,984 has been reclassified from inventory to customer advances in consolidated balance sheet as at December 31, 2008. As of September 30, 2009 and December 31, 2008, the Company has reclassified certain other customer advances and deferred revenue previously recorded in accounts payable and accrued liabilities to conform with the current period's presentation. These reclassified amounts resulted in an increase in the total assets and liabilities of the Company, but had no impact on net working capital or earnings.

The following balance sheet categories were adjusted as follows:

	December 31, 2008 as previously reported	Increase (decrease)	December 31, 2008 as restated
Inventories, net	\$ 44,278	\$ 14,984	\$ 59,262
Accounts payable and accrued liabilities	32,995	(6,277)	26,718
Other current liabilities	546	21,261	21,807

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

3. ACCOUNTING POLICY CHANGES

Effective January 1, 2009 the Company adopted the following new Canadian Institute of Chartered Accountants (CICA) accounting standards:

Goodwill and Intangible Assets

Section 3064, *Goodwill and Intangible Assets*, which replaces Section 3052, *Goodwill and Intangible Assets*, and Section 3450, *Research and Development Costs*. CICA 3064 establishes standards for recognition, measurement and disclosure of goodwill and intangible assets. The provision relating to the definition and initial recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provision of the International Financial Reporting Standards (IFRS) IAS 38, *Intangible Assets*. The adoption of Section 3064 had no impact on the Company's consolidated financial statements.

New Pronouncements

International Financial Reporting Standards (IFRS)

The CICA Accounting Standards Board has confirmed that the IFRS will be mandatory in Canada for financial statements of profit oriented publicly accountable entities beginning on or after January 1, 2011. The Company is monitoring the changes arising from this convergence and is in the process of preparing a plan to address accounting and reporting changes that will be necessary to convert the Company's consolidated financial statements to IFRS.

4. SUPPLEMENTARY INFORMATION

a) Inventory, net comprises the following:

	September 30 2009	December 31 2008 (restated)
Raw materials	\$ 3,072	\$ 3,075
Work in process (including costs on incomplete contracts)	99,927	82,918
Estimated earnings on long-term contracts in process	8,003	5,191
Finished goods	1,268	1,258
Progress billings on long-term contracts	(45,008)	(33,180)
Total Inventories	\$ 67,262	\$ 59,262

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

b) Other long-term assets comprise the following:

	September 30 2009	December 31 2008
Cost of rights under revenue sharing agreement, net of amortization of \$13,402 (2008 -\$10,676) (note 5)	\$ 7,913	\$ 8,200
Revenue share agreement spares prepayment (note 5)	266	1,842
Tooling	1,449	1,070
Rent deposit	669	592
Other	720	647
Total other long-term assets	\$ 11,017	\$ 12,351

c) Other current liabilities comprise the following:

	September 30 2009	December 31 2008
Future income taxes	\$ 859	\$ 546
Deferred revenue	1,634	927
Customer advances	14,848	20,334
Total other current liabilities	\$ 17,341	\$ 21,807

d) Other long-term liabilities comprise the following:

	September 30 2009	December 31 2008
Pensions and post-retirement benefits	\$ 7,985	\$ 7,445
Environmental remediation (note 9)	7,995	8,863
Environmental litigation settlement (note 9)	4,656	-
Future income tax liability	2,926	2,097
Interest rate swap contracts	2,124	3,240
Other	919	824
	26,605	22,469
Less current portion of other long-term liabilities	5,159	2,717
Total other long-term liabilities	\$ 21,446	\$ 19,752

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

Interest rate swaps:

In 2008, \$25,000 of the total \$40,000 interest rate swap contracts outstanding qualified for hedge accounting and the unrealized gain or loss on these contracts was included as a component of other comprehensive loss for the period. As a result of the amended debt agreement, the \$25,000 of interest rate swaps designated as a cash flow hedge are no longer effective. Accordingly the changes in fair value of the interest rate swaps are recorded in the consolidated statement of operations. With the debt repayments in the second quarter of 2009, the Company cancelled \$10,000 of the outstanding contracts to match the outstanding debt on the credit agreement of \$30,000 at June 30, 2009. The Company paid \$590 for cancellation of these contracts.

e) Long-term debt

The Company entered into an \$80,000 credit facility in March 2007. This facility consisted of a \$60,000 revolving credit facility and a \$20,000 term loan. The term loan's scheduled quarterly repayment installments of \$1,000 began September 30, 2007. In the first quarter of 2008, the Company entered into an amendment to the existing credit facility to amend the financial covenants for 2008. As a result of the amendment, the Company paid \$120 as a fee and paid an additional 0.25% to 0.50% in interest based on the Company's leverage ratio. Furthermore, the required principal payments for 2008 were reduced from \$4,000 to \$3,000. As of December 31, 2008, the applicable interest rate on outstanding bank borrowings ranged from 7.000% to 9.625%. The Company has pledged substantially all of its assets as collateral for the loan facility.

On December 31, 2008, the Company received an amendment to the credit facility that contained a waiver for a covenant violation at September 30, 2008 and adjusted the financial covenants as of December 31, 2008. As a result of the amendment, the Company paid a \$300 fee and an additional 1.50% to 2.75% in interest based on the Company's leverage ratio. Furthermore, the amendment required the Company to pay down debt by \$25,000 by April 30, 2009. In January 2009, the Company sold its investment in Vector Aerospace for approximately Cdn \$14,191 and recorded a gain of \$5,990, net of commissions and legal costs in the consolidated statement of operations. The net proceeds from the sale of the investment along with Cdn \$500 received in December 2008 related to a settlement of a previously written off investment were used to pay down debt by \$11,715 in January 2009. In March 2009, the Company paid down an additional \$5,000 through the realization of proceeds from GEA's sale of the Company's spare parts inventory related to the CF34-3 that was held on consignment at GEA's locations.

In March 2009, the Company obtained an additional amendment to the credit agreement. This amendment reduced the maximum available credit from \$75,000 to \$57,500 and accelerated the maturity date of the facility from March 2012 to October 2010. The amendment changed the \$8,285 repayment due on April 30, 2009 to \$7,500 due by July 31, 2009. In May 2009, the Company completed the sale of the assets and certain liabilities of a subsidiary (Note 7). The proceeds from this transaction were used

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

to satisfy the remaining debt repayment requirement. With this payment, the maximum available borrowings were reduced to \$50,000. The interest rate on the facility is the Company's option of an adjusted base rate plus 4.50% or the London Interbank Offered Rate (with a floor of 3.0%) plus 4.75%. The fee for letters of credit was increased from 1.0% to 4.75%. The Company paid additional fees of \$383 for the March 2009 amendment.

Due to the material term changes in the March 2009 amendment, the Company wrote off the deferred financing cost balance of \$309 associated with the facility prior to the amendment. At September 30, 2009, unamortized deferred financing costs of \$247 (December 31, 2008 - \$346) associated with the amended credit facility were recorded as a reduction of long-term debt. The Company amortizes these costs over the expected life of the credit facility using the effective interest method. The amortization amounts are included as net interest expense.

As disclosed in note 1, there is a risk that the Company may not be able to meet the new financial covenant requirements in future periods. There can be no assurance that the Company would be able to obtain a further amendment to the credit agreement or to obtain the financing necessary to continue as a going concern.

f) Income tax provision

For the three and nine months ended September 30, 2009, the Company's income tax provision includes a tax expense of \$1,709 and \$3,233, respectively, related mainly to the U.S. continuing operations (2008 – \$752 recovery and \$963 expense, respectively). For the nine months ended September 30, 2009, the Company recorded a gain of \$5,990 (net of commissions and legal costs) related to the sale of its investment in Vector Aerospace Corporation. The tax provision related to this gain was previously recorded in accumulated other comprehensive income and has been transferred to the statement of operations upon the sale of the investment. The Company had sufficient capital loss carry-forwards to offset the gain and accordingly, there are no current taxes payable.

The future tax benefit of \$608 related to the interest rate swap contracts recognized in accumulated other comprehensive income at December 31, 2008 has also been transferred to the statement of operations during the nine month period ended September 30, 2009 since the related hedges are no longer effective.

For the three and nine months ended September 30, 2009, as disclosed in the Company's 2008 annual report, the Company did not record a tax benefit for the losses generated from the Canadian operations and corporate costs. This benefit would have been approximately \$835 and \$2,535, respectively for the three and nine months ended September 30, 2009 to offset the net tax provision related to the U.S. operations.

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(in thousands of U.S. dollars)

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g) Earnings per share

The calculation of earnings per share for the three and nine month period ending September 30, 2009 is based on the weighted average number of shares outstanding of 29,880,318 (three and nine months ending September 30, 2008 – 29,880,318 and 29,875,024, respectively). Diluted earnings per share reflect the dilutive effect of the exercise of options where the grant price was below the average market price for the period ended September 30. The dilutive effect of options for the three and nine months of 2009 and 2008 was nil.

h) Incentive Stock Option Plan

At September 30, 2009, there were 1,577,000 (December 31, 2008 – 1,634,000) options outstanding. During the nine months ended September 30, 2009, 57,000 (2008 – 363,000) options expired or were cancelled.

i) Benefit Plans

Information regarding the benefit expense of the defined benefit pension plans and the post-retirement plan is as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Defined Benefit Plan Expense				
Current service cost	\$ 10	\$ 133	\$ 30	\$ 369
Interest cost	106	225	318	775
Actual return on plan assets	(2)	-	(6)	-
Difference in costs arising in the period and costs recognized in the period regarding:				
Return on plan assets	-	(190)	-	(570)
Actuarial loss not yet amortized	(2)	6	(6)	18
Net plan benefit expense	\$ 112	\$ 174	\$ 336	\$ 592
Post-Retirement Plan Expense				
Current service cost	\$ 7	\$ 10	\$ 21	\$ 30
Interest cost	22	22	66	66
Difference in costs arising in the period and costs recognized in the period regarding:				
Actuarial gain not yet amortized	(24)	(21)	(72)	(63)
Plan amendments	6	7	18	21
Net plan benefit expense	\$ 11	\$ 18	\$ 33	\$ 54



Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

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j) Supplemental cash flow information

Details of changes in working capital from continuing operations:

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Cash provided by (used in):				
Accounts receivable	\$ 276	\$ 36	\$ 6,109	\$ 10,371
Inventories and customer advances	(7,492)	7,255	(5,662)	1,009
Other current assets	479	187	539	571
Accounts payable and accrued liabilities	5,638	(1,045)	4,169	(1,251)
Other current liabilities	(2,428)	(255)	(4,760)	(1,378)
Other long-term assets and liabilities	(514)	(1,200)	(2,760)	(4,981)
Net change in non-cash working capital	\$ (4,041)	\$ 4,978	\$ (2,365)	\$ 4,341

The change in other long-term assets and liabilities relates to payments under the Revenue Sharing Agreement (note 5) and environmental payments (note 9), respectively.

Details of non-cash financing and investing activities:

During the three and nine months ended September 30, 2009, the Company acquired \$nil and \$569, respectively (2008 – \$73 and \$2,528, respectively) of equipment through capital leases for continuing operations. As described further in Note 7, \$1,247 of the proceeds from the sale of discontinued operations were recorded as a receivable to be paid upon the finalization of working capital adjustments. At September 30, 2009 the remaining receivable of \$378 is included in other current assets in the consolidated balance sheet.

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

5. RISK AND REVENUE SHARING AGREEMENT

In June 2004, the Company's Canadian subsidiary entered into a Risk and Revenue Sharing Agreement ("RSA") with GE Aviation ("GEA") to produce components for the CF34-3 engines used in Bombardier Regional Jets and Challenger Business Jets. Under this agreement, the Company earns revenue based on a percentage of GEA's sales of new engines and spare parts for the life of the program.

The Company paid \$4,000 upon executing this agreement and an additional \$2,333 in 2004 and \$11,666 in 2005 for participation in the RSA. Upon executing the agreement, an asset of \$17,139 was recorded in other assets consisting of the cash paid, legal costs and the present value of the obligation at that time (\$13,074 using an 8% discount rate). The asset value of the contract, net of accumulated amortization is as follows:

	Three Months Ended September 30		Nine Months Ended September 30		Year Ended December 31
	2009	2008	2009	2008	2008
Asset capitalized cost on inception	\$ 17,139	\$ 17,139	\$ 17,139	\$ 17,139	\$ 17,139
Currency translation adjustment	4,176	5,197	4,176	5,197	1,737
Adjusted historic cost	21,315	22,336	21,315	22,336	18,876
Accumulated amortization					
at beginning of period	(12,138)	(12,108)	(10,676)	(11,408)	(11,408)
Current period expense	(406)	(734)	(1,240)	(1,705)	(1,819)
Currency translation adjustment	(858)	279	(1,486)	550	2,551
Accumulated amortization at end of period	(13,402)	(12,563)	(13,402)	(12,563)	(10,676)
Net asset at end of period	\$ 7,913	\$ 9,773	\$ 7,913	\$ 9,773	\$ 8,200

The agreement requires the Company to make additional payments to GEA of up to \$3,000 upon reaching specific levels of engine sales. Upon reaching a specific level of spare part sales, the Company was required to pay GEA 50% of the sales exceeding that level through December 31, 2008. An additional \$5,000 will be paid if spare parts sales reach \$25,000 subsequent to January 1, 2009. The Company has estimated the total amount of these additional payments and will recognize these estimated payments over the economic life of the contract. The accumulated asset for the engine and spare parts sales is as follows:

	Three Months Ended September 30		Nine Months Ended September 30		Year ended December 31
	2009	2008	2009	2008	2008
Asset at beginning of period	\$ 464	\$ 2,485	\$ 1,842	\$ 952	\$ 952
Current period expense	(133)	(276)	(2,427)	(1,171)	(3,211)
Current period payments	-	794	919	3,251	4,095
Currency translation adjustment	(65)	30	(68)	1	6
Asset at end of period	\$ 266	\$ 3,033	\$ 266	\$ 3,033	\$ 1,842

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

6. OTHER COMPREHENSIVE INCOME

With the realization of the gain on the sale of the investment in Vector Aerospace in January 2009 and the termination of the ability to account for the \$25,000 of interest rate swap contracts as an effective cash flow hedge, the previously recorded net unrealized gain on the available for sale asset (\$3,714) and loss on cash flow hedge (\$961) were transferred from other comprehensive income to the Company's consolidated statement of operations during the nine month period ended September 30, 2009.

The components of accumulated other comprehensive income are as follows:

	September 30 2009	December 31 2008
Available for sale financial assets, net of taxes (December 31, 2008 - \$701)	\$ -	\$ 3,714
Derivatives designated as cash flow hedges, net of taxes (December 31, 2008 - \$608)	-	(961)
Currency translation adjustment	6,511	3,732
Accumulated other comprehensive income	\$ 6,511	\$ 6,485

7. DISCONTINUED OPERATIONS

In the fourth quarter of 2008, the Company announced plans to divest its repair and overhaul operation, Northstar Aerospace Turbine Engine Service Group, Inc. ("TESG") located in Stroud, Oklahoma, to focus on its core business of manufacturing gears and transmissions. Results from TESG were previously reported in the commercial market segment and are reported as discontinued operations in the accompanying financial statements for all periods presented.

On May 27, 2009, the Company completed the sale of the assets and certain liabilities of TESG recognizing gross proceeds of \$9,447 including an estimated adjustment for working capital of \$1,447 and a loss on the transaction of \$2,039 including the related transaction costs. As the sale was by one of the Company's U.S. subsidiaries, there is an income tax benefit of \$752 related to this loss.

Of the \$9,447 gross proceeds from the sale, the Company received cash of \$7,484, net of transaction costs of \$716, with the balance of \$1,247 due upon finalization of the working capital adjustment. At September 30, 2009, the working capital adjustment was in the process of being determined. The remaining receivable related to this transaction of \$378 is included in other current assets at September 30, 2009 in the Company's interim consolidated balance sheet. The terms of the asset purchase agreement required the Company to issue a letter of credit for \$500 for 18 months to cover its representations and warranties.

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

Included in net loss, discontinued operations in the consolidated statements of operations are the following:

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Revenues	\$ -	\$ 3,681	\$ 5,998	\$ 11,387
Cost of sales	-	3,017	4,264	8,722
Selling, general and administration	-	493	855	1,454
Depreciation & amortization	-	74	188	218
Interest, net	-	12	20	12
Income before income undernoted	-	85	671	981
Loss on sale	-	-	(2,039)	-
Realized currency translation adjustment	-	-	14	-
(Loss) income before income taxes	-	85	(1,354)	981
Income tax expense	-	31	(502)	387
Net (loss) income, discontinued operations	\$ -	\$ 54	\$ (852)	\$ 594

There were no assets or liabilities related to the discontinued operations at September 30, 2009. The net assets of the discontinued operations included in the accompanying balance sheets as of December 31, 2008 are the following:

	December 31 2008
Accounts receivable, net	\$ 2,415
Inventories, net	4,622
Other current assets	196
Total current assets	7,233
Property, plant and equipment, net	4,600
Other long-term assets	138
Total assets	\$ 11,971
Accounts payable and accrued liabilities	2,291
Current portion of long-term debt	238
Total current liabilities	2,529
Long-term debt	1,059
Net assets of discontinued operations	\$ 8,383

The discontinued operations used cash flow from operations for the nine months ended September 30, 2009 and generated cash flow for the three and nine months ended

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

September 30, 2008 as the net income realized was adjusted for the non-cash charge for depreciation and the changes in working capital, primarily the changes in accounts receivable during those periods. Cash used in or provided by investing activities for these periods was the net activity of cash used for the purchase of capital equipment or rental engines offset by cash received from the sale of rental engines. Cash used in financing activities in 2008 and 2009 were primarily payments on capital lease obligations.

8. UNUSUAL ITEMS

In January 2009, the Company sold its investment in Vector Aerospace Corporation for gross proceeds of approximately Cdn. \$14,191 (3,638,750 common shares at Cdn \$3.90 per share) resulting in a gain of \$5,990, net of commissions and legal costs.

In May 2009, the Company entered into a settlement agreement related to a class action claim for Cdn \$5,050 (Note 9). With this agreement in place, the amount of liability is known and accordingly, the Company recorded a provision of \$4,135 in the second quarter of 2009.

9. ENVIRONMENTAL MATTERS AND CONTINGENCIES

To date, the Company has provided \$22,449 for estimated environmental testing and remediation costs in respect to environmental issues relating to the Cambridge, Ontario facility of the Company's subsidiary Northstar Aerospace (Canada) Inc. ("Northstar Canada").

The accumulated liability for environmental remediation at September 30, 2009 and December 31, 2008 is as follows:

	Three Months Ended		Nine Months Ended		Year ended
	September 30		September 30		December 31
	2009	2008	2009	2008	2008
Liability at beginning of period	\$ 7,955	\$ 12,129	\$ 8,863	\$ 13,785	\$ 13,785
Payments	(514)	(379)	(1,841)	(1,721)	(2,650)
Currency translation adjustment	554	(271)	973	(585)	(2,272)
Liability at end of period	\$ 7,995	\$ 11,479	\$ 7,995	\$ 11,479	\$ 8,863

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

Based on information currently available, management estimates that the remaining accrual is sufficient for such testing and remediation costs. However, estimates for remediation are based on a number of assumptions which are inherently difficult to determine and no assurance can be given that the actual costs will not differ from the estimates based on environmental test results, changes in laws, regulations or enforcement policies or other factors. Management's estimates are based on projected requirements through 2012. Estimates beyond 2012 are dependent on the accuracy of the various assumptions through 2012, as well as the items noted above.

The environmental specialists retained to support Northstar Canada's investigative and remedial efforts have identified an additional source of the contamination that is not attributable to Northstar Canada's operations. Efforts to more fully delineate the contribution by this additional source continue. Management's estimates for remediation costs exclude Northstar Canada's responsibility for the area currently assumed to be the responsibility of this additional source. Furthermore, management's remediation cost estimates currently exclude reimbursement to Northstar Canada by the additional source for costs incurred by Northstar Canada prior to that source being identified.

The Company and Northstar Canada were defendants in a class proceeding in the Ontario Superior Court of Justice (Toronto) wherein the plaintiffs claimed damages for negligence, nuisance, breach of duty and related issues. In May 2009, the Company and Northstar Canada reached a settlement agreement with representatives of the class members. The settlement was approved by the Court in June 2009. Pursuant to the settlement agreement the class was certified for settlement purposes and the Company and Northstar Canada were to contribute Cdn \$5,050 towards two damages funds: one from which the class members' claims will be satisfied through a claims administration process, and a second from which class members' legal costs will be paid. The settlement is payable as follows: \$1,550 in October 2009, Cdn \$500 in March 2010, and Cdn \$3,000 in a promissory note with principal and interest (3.3% per year) payable no later than October 2012. As part of the Court order approving the settlement, the class proceeding was dismissed. The Company recorded a provision of \$4,135 (Cdn \$5,050) as an unusual item in the interim consolidated statement of operations in the second quarter of 2009.

In October 2006 and May 2007, the Regional Municipality of Waterloo and the Grand River Conservation Authority commenced claims (Cdn \$1,200 and Cdn \$1,000, respectively) in the Ontario Superior Court of Justice against the Company and Northstar Canada for damages and for contribution and indemnity for any claims that may be brought against the Region or the Conservation Authority in relation to the same environmental concerns as set forth in the above class action. The Company and Northstar Canada have agreed to tolling agreements with the Corporation of the City of Cambridge for any claims either party may bring forward against the other in relation to the same environmental concerns.

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

The Company and Northstar Canada are also defendants in another claim related to the environmental concerns noted above commenced in the Ontario Superior Court of Justice. In this claim, the plaintiffs are seeking general and punitive damages of Cdn \$213,200 for damages to health and property values. This claim was instituted in February 2008. If successful, this claim could involve significant damages which would have a material adverse effect on the financial condition of the Company and Northstar Canada and sufficient resources may not be available to satisfy such claim. Each of the Company and Northstar Canada are taking a pro-active approach in response to the claim, believe that they have strong defenses to such claim, and believe the quantum of damages being sought is inflated and not based on any reasoned calculation of loss.

All the above unresolved claims have been referred to counsel. The Company and Northstar Canada intend to take all appropriate actions to defend their position. These claims are still in their early stages and as such, an assessment of potential liability, if any, cannot be determined. Accordingly, no provision has been made in the financial statements related to these claims. However, provision has been made for the ongoing environmental testing and remediation as noted previously.

The Company had previously been served with six individual actions related to operations at Northstar Aerospace Turbine Engine Service Group, Inc. in Stroud, Oklahoma. Each action names in excess of 10 defendants and seeks damages (in undetermined amounts and including punitive damages) for alleged acts of negligence that resulted in wrongful death in connection with an aircraft crash on or about July 29, 2006 during a skydiving expedition near Sullivan, Missouri. The Company was released without prejudice from each of the six actions in February and March 2009. In July 2009, the Company received notice of an additional claim related to this matter. This incident is fully insured and the Company's insurance provider is defending the action. The Company and its insurance provider are seeking a similar release as was received on the other six actions.

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

10. SEGMENT INFORMATION

The continuing operations of the Company relate to the aerospace industry and are organized and managed as business segments defined below. As a result of the divestiture of the repair and overhaul operations of Northstar Aerospace Turbine Engine Services Group Inc., the prior year's disclosures have been restated to conform to the current year's presentation:

Segment Information for Continuing Operations

		Three Months Ended September 30		Nine Months Ended September 30	
		2009	2008	2009	2008
Revenue	Defense	\$ 38,760	\$ 29,071	\$ 105,178	\$ 85,983
	Commercial	9,338	10,954	35,024	34,134
		48,098	40,025	140,202	120,117
Cost of Sales	Defense	29,588	22,702	81,755	66,273
	Commercial	8,498	10,219	29,725	30,507
		38,086	32,921	111,480	96,780
Gross Margin, excluding depreciation and amortization	Defense	9,172	6,369	23,423	19,710
	Commercial	840	735	5,299	3,627
		10,012	7,104	28,722	23,337
Selling, general and administration		4,908	4,464	14,900	12,554
Foreign exchange loss (gain)		338	(174)	554	(666)
Depreciation and amortization		1,578	1,731	4,987	5,218
Unusual items (note 8)		-	-	(1,855)	-
Interest, net		1,949	1,561	4,858	4,764
Write off of deferred financing costs		-	-	309	-
(Gain) loss on interest rate swap contracts		(59)	24	1,045	85
Income (loss) before income taxes from continuing operations		\$ 1,298	\$ (502)	\$ 3,924	\$ 1,382

Defense – The main products for military markets include helicopter gears and transmissions, helicopter rotor heads, accessory gearboxes for engines used in military aircraft and maintenance, repair and overhaul (“MRO”) services for helicopter transmissions and gear boxes and aircraft gear boxes.

Commercial – The main products include components for auxiliary power units and accessory gearboxes for fixed wing aircraft, machining and fabrication services, and MRO services for aerostructures and transmission parts.



Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

Geographic Information

Revenue is attributed to geographic location based on the location of the business unit reporting the revenue, and was comprised as follows:

Three Months Ended September 30				
Revenue	Canada	United States	Intercompany	Total
2009	\$8,552	\$41,837	(\$2,291)	\$48,098
2008	\$8,113	\$33,832	(\$1,920)	\$40,025

Nine Months Ended September 30				
Revenue	Canada	United States	Intercompany	Total
2009	\$32,256	\$116,657	(\$8,711)	\$140,202
2008	\$25,663	\$99,710	(\$5,256)	\$120,117

Of this revenue, Canada sales to foreign customers totaled approximately \$8,124 and \$31,454, respectively, in the three and nine months ended September 30, 2009 (2008 - \$7,474 and \$23,909, respectively).

The same long-term fixed assets are used for both the commercial and defense aerospace manufacturing segments. Accordingly, the property, plant, equipment and goodwill cannot be specifically allocated to these segments. The Company's long-lived assets identified by geographic location at September 30, 2009 and December 31, 2008 are as follows:

	Canada		United States		Total	
	2009	2008	2009	2008	2009	2008
Property, plant and equipment	\$11,393	\$9,942	\$31,344	\$32,406	\$42,737	\$42,348
Goodwill	-	-	\$2,436	\$2,436	\$2,436	\$2,436

Notes to Consolidated Interim Financial Statements

(in thousands of U.S. dollars)

UNAUDITED

Significant Customers for Continuing Operations

Customers individually representing more than 10% of defense revenue in the three and nine months ended September 30, 2009 were The Boeing Company and the U.S. Government. These customers, in aggregate, accounted for approximately 82.3% and 81.5% of defense revenue, in the three and nine months ended September 30, 2009, respectively, and 85.1% and 83.6% in the three months and nine month ended September 30, 2008, respectively.

Customers individually representing more than 10% of commercial revenues in the three and nine months ended September 30, 2009 were GEA, Honeywell International Inc. and Rolls-Royce. These customers, in aggregate, accounted for approximately 80.1% and 77.5% of commercial revenue, in the three and nine months ended September 30, 2009, respectively, and 73.2% and 71.0% in the three and nine months ended September 30, 2008, respectively.

No other customer represents more than 10% of consolidated revenues. At September 30, 2009, approximately 81% of accounts receivable (December 31, 2008 – 78%) relates to balances from these five customers.



NORTHSTAR AEROSPACE, INC.

MANAGEMENT'S DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars)

Management's Discussion and Analysis ("MD&A") is intended to assist in understanding the results of operations and the financial condition of Northstar Aerospace, Inc. (the "Company") and should be read in conjunction with the Company's unaudited interim consolidated financial statements and notes. Past performance may not be indicative of future performance. Results are reported in U.S. dollars unless otherwise stated and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

This discussion contains forward-looking statements that are subject to risks and uncertainty. All statements, other than statements of historical facts included in this MD&A, including, without limitation, those regarding the Company's financial position, business strategy, projected costs and plans, projected revenues, objectives of management for future operations, and certain items discussed in "Risks and Uncertainties" in the Company's 2008 annual report may be or include forward-looking statements. Forward-looking information contained herein is based upon a number of assumptions regarding the Canadian, U.S. and global economic environment, local and foreign government policies and actions. Actual future results of the Company may differ materially depending on a variety of factors, including production rates, timing of product deliveries, Canadian, U.S. and foreign government activities, volatility of the market for the Company's products and services, worldwide political stability, factors that result in significant and prolonged disruption to commercial air travel worldwide, U.S. military activity, domestic and international economic conditions, and other political and economic risks, including currency risks, and uncertainties.

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Company's expectations ("Cautionary Statements"), including those set forth under the caption "Risks and Uncertainties", are disclosed in the Company's 2008 annual report and in the Company's Annual Information Form filed on March 31, 2009. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on behalf of the Company are expressly qualified in their entirety by the Cautionary Statements.

The forward-looking information contained herein is current only as of the date of this document. The Company disclaims any intentions or obligation to update or revise any forward-looking statements or comments as a result of any new information, future event or otherwise, unless such disclosure is required by law. The following discussion and analysis is provided as of November 5, 2009.

The information included in this MD&A should be read in conjunction with the unaudited consolidated interim financial statements of the Company as of September 30, 2009 and the 2008 audited consolidated financial statements in the Company's 2008 annual report and the notes thereto. Unless otherwise indicated, all reported amounts are in thousands of U.S. dollars. **The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2009 have not been subjected to a review by the Company's auditors as described in CICA 7050.**

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

BUSINESS OVERVIEW

The Company manufactures flight-critical parts for military and commercial aircraft applications and certain non-flight-critical parts for commercial aircraft. The Company's facilities are located in the United States and Canada. The principal parts and assemblies manufactured are gears, shafts, gearboxes and other related components for helicopter transmissions, helicopter rotor heads, accessory gearboxes for aircraft engines, and components for auxiliary power units. Additionally, the Company carries out machining and fabrication services for a variety of aerospace applications and provides maintenance, repair and overhaul ("MRO") services for drive systems and aerostructures.

In the fourth quarter of 2008, the Company announced plans to divest its repair and overhaul operation, Northstar Aerospace Turbine Engine Service Group, Inc. ("TESG") located in Stroud, Oklahoma, to focus on its core business of manufacturing aerospace gears and transmissions. TESG performed MRO services on Pratt and Whitney PT6T and PT6A engines used for small turboprop aircraft and helicopters. Results from this operation were previously disclosed in the commercial market segment and are reflected as discontinued operations for the three and nine months ended September 30, 2009 and 2008. The sale of the assets and certain liabilities of TESG was completed in May 2009.

Management believes certain long-term trends will impact the future of the aerospace markets that the Company serves. These trends include: (i) increased outsourcing by the original equipment manufacturers ("OEMs"); (ii) consolidation of the supplier base; (iii) global sourcing of components for commercial aircraft, and (iv) retrofit and upgrade of military aircraft fleets. The Company believes it has aligned its ongoing operations with these trends.

The principal markets served by the Company are the defense and commercial aerospace. The Company manufactures a wide range of products for these markets. The percentages of the Company's revenues from continuing operations generated from the defense and commercial aerospace markets in the three months ended September 30, 2009 were 80.6% and 19.4%, respectively, and in the three months ended September 30, 2008 were 72.6% and 27.4%, respectively. The percentages of the Company's revenues from continuing operations generated from the defense and commercial aerospace markets in the nine months ended September 30, 2009 were 75.0% and 25.0%, respectively, and in the nine months ended September 30, 2008 were 71.6% and 28.4%, respectively.

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

GOING CONCERN

The accompanying unaudited consolidated financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and the liquidation of liabilities in the normal course of business. The use of such principles may be inappropriate because of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern. The Company has incurred significant losses from 2006 through 2008, attributable to operations, to restructurings and charges related to the environmental remediation at the Company's Canadian subsidiary. Over these years, the losses incurred have resulted in violations of the Company's credit agreements. The most recent violations at September and December 2008 were at a time when the global credit market crisis made the availability of funds more limited and the required financial performance metrics for accessing those funds more difficult to achieve.

As discussed further in the Liquidity and Capital Resources section herein, the Company obtained amendments to its existing credit facility in December 2008 and March 2009 to resolve the covenant violations at September 2008 and December 2008. The Company repaid a total of \$16,715 through payments made in January and March 2009. The amended credit agreement required an additional \$7,500 to be paid by July 31, 2009. Using the proceeds from the TESG transaction, the Company made a debt repayment of \$8,180 in May 2009.

The terms of the March 2009 amendment include moving the maturity date of the loan from March 2012 to October 1, 2010. The Company's ability to maintain compliance with the terms of the agreement is essential to the Company's ability to continue as a going concern. The amendment revised the covenants to be in line with management's 2009 operating plan. The Company's ability to meet these covenants is dependent on the Company's ability to realize its 2009 and 2010 operating plans. The Company is subject to significant risks in achieving these plans. These risks are further discussed in the Risks and Uncertainties section and note 1 to the Company's consolidated financial statements for the three and nine months ended September 30, 2009. As of September 30, 2009, the Company is in compliance with the covenants of the amended credit facility.

The Company will require bank financing subsequent to the revised maturity date of October 2010. The Company's ability to obtain that financing is dependent on the Company's performance as well as the availability of funds in the credit markets. There can be no assurance that the Company will be able to obtain the financing necessary to continue as a going concern even if it achieves its operating plan.

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

The Company's ability to continue as a going concern is dependent on many events, some of which are outside of the direct control of management, including the risks noted above. The significant recent losses and the resulting violations of bank covenants, among other factors, raise significant doubt as to the Company's ability to continue as a going concern. The accompanying unaudited consolidated financial statements do not include any adjustments in the carrying values of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used, that would be necessary if the Company were unable to realize its assets and discharge its liabilities as a going concern in the normal course of operations and such adjustments could be material.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The Company evaluates its estimates on an on-going basis, including those related to revenues and expenses where percentage of completion accounting is applied, bad debts, inventories, investments, intangible assets, contingent payments for the General Electric Aviation ("GEA") Risk and Revenue Sharing Agreement ("RSA"), income taxes, litigation, environmental liabilities, and other contingencies. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The results of these estimates and assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

CHANGES IN ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

The consolidated financial statements of the Company are prepared in accordance with GAAP. The Company has identified the accounting policies that are critical to the understanding of the Company's operations and financial results in the Company's 2008 annual report. The interim consolidated financial statements of the Company and notes thereto for the three and nine months ended September 30, 2009 have been prepared using the same accounting principles and methods as were used for the Company's 2008 annual report.

As more fully described in Note 3 to the Consolidated Financial Statements, on January 1, 2009, the Company adopted Handbook Section 3064, Goodwill and Intangible Assets and Section 3450, Research and Development Costs as required by the Canadian Institute of Chartered Accountants ("CICA"). The adoption of Section 3064 had no impact on the Company's consolidated financial statements.

International Financial Reporting Standards

The CICA Accounting Standards Board has confirmed that the IFRS will be mandatory in Canada for financial statements of profit-oriented, publicly accountable entities beginning on or after January 1, 2011. The Company is closely monitoring the changes arising from this convergence and is in the process of preparing a plan to address accounting and reporting changes that will be necessary to convert the Company's consolidated financial statements to IFRS.

The Company has launched an internal initiative to govern the conversion process and is currently evaluating the potential impact of the conversion to IFRS on its financial statements. At this time, the impact on the Company's future financial position and results of operations is not reasonably determinable or estimable. The Company expects the transition to IFRS to impact accounting, financial reporting, internal control over financial reporting, information systems and business processes.

The Company has developed a formal project governance structure and provides regular progress reports to senior management. The Company has also completed a diagnostic impact assessment, which involves a high level review of the major differences between current GAAP and IFRS. Based on this diagnostic assessment, the Company has established a conversion plan that includes detailed steps for conversion, project milestones, assignment of work to staff personnel and their training requirements.

During 2009, the Company will continue to assess the impact of the transition to IFRS and to review all of the proposed and ongoing projects of the International Accounting Standards Board to determine their impact on the Company. Additionally, the Company will continue to invest in training and resources, where necessary, throughout the transition period to facilitate a timely conversion.

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

GEA RISK AND REVENUE SHARING AGREEMENT

In June 2004, the Company's Canadian subsidiary entered into a Risk and Revenue Sharing Agreement ("RSA") with General Electric Aviation ("GEA") to produce components for the CF34-3 engines used in Bombardier Regional Jets and Challenger Business Jets. Under this agreement, the Company earns revenue based on a percentage of GEA's sales of new engines and spare parts for the life of the program.

The Company paid \$4,000 upon executing this agreement and an additional \$2,333 in 2004 and \$11,667 in 2005 for participation in the RSA. Upon executing the agreement, an asset of \$17,139 was recorded in other assets consisting of the cash paid, legal costs and the present value of the obligation at that time (\$13,074 using an 8% discount rate). The change in the asset value of the contract, net of accumulated amortization is as follows:

	Three Months Ended September 30		Nine Months Ended September 30		Year Ended December 31
	2009	2008	2009	2008	2008
Asset capitalized cost on inception	\$ 17,139	\$ 17,139	\$ 17,139	\$ 17,139	\$ 17,139
Currency translation adjustment	4,176	5,197	4,176	5,197	1,737
Adjusted historic cost	21,315	22,336	21,315	22,336	18,876
Accumulated amortization					
at beginning of period	(12,138)	(12,108)	(10,676)	(11,408)	(11,408)
Current period expense	(406)	(734)	(1,240)	(1,705)	(1,819)
Currency translation adjustment	(858)	279	(1,486)	550	2,551
Accumulated amortization at end of period	(13,402)	(12,563)	(13,402)	(12,563)	(10,676)
Net asset at end of period	\$ 7,913	\$ 9,773	\$ 7,913	\$ 9,773	\$ 8,200

The agreement requires the Company to make additional payments to GEA of up to \$3,000 upon reaching specific levels of engine sales. Upon reaching a specific level of spare part sales, the Company was required to pay GEA 50% of the sales exceeding that level through December 31, 2008. An additional \$5,000 would be paid if spare parts sales reach \$25,000 subsequent to January 1, 2009. The Company has estimated the total amount of these additional payments and will recognize these estimated payments over the economic life of the contract. The change in the accumulated asset for the engine and spare parts sales is as follows:

	Three Months Ended September 30		Nine Months Ended September 30		Year ended December 31
	2009	2008	2009	2008	2008
Asset at beginning of period	\$ 464	\$ 2,485	\$ 1,842	\$ 952	\$ 952
Current period expense	(133)	(276)	(2,427)	(1,171)	(3,211)
Current period payments	-	794	919	3,251	4,095
Currency translation adjustment	(65)	30	(68)	1	6
Asset at end of period	\$ 266	\$ 3,033	\$ 266	\$ 3,033	\$ 1,842

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

NON-GAAP MEASURES

The Company defines adjusted net income (loss), comparable basis as income from operations before income taxes.

The Company defines EBITDA as earnings from net income before interest, income taxes, foreign exchange, depreciation and amortization, unusual items, loss on interest rate swap contracts and other non-recurring items. EBITDA and adjusted net income before income taxes are used by management to evaluate the Company's performance as compared to other companies in the industry that have different financing and capital structures and/or tax rates.

Furthermore, the Company has included information concerning EBITDA and adjusted net income before income taxes because the Company believes these measures are used by certain investors as measures of continuing financial performance. These measures are not measures of financial performance under Canadian generally accepted accounting principles ("GAAP"). As well, these measures have no standardized meaning prescribed under GAAP and are unlikely to be comparable to similarly titled measures used by other companies. These measures should not be construed as an alternative to cash flow from operations or earnings from operations as determined in accordance with GAAP as measures of liquidity or earnings.

The Company's provision for environmental liabilities, legal settlements, restructuring and severance costs, plant shutdown costs, the write-off of long-lived assets, gain on sale of investments, gain (loss) on interest rate swap contracts, and write off of deferred financing costs are included as adjusting items to arrive at EBITDA and adjusted net income before income taxes as these matters are not recurring by nature.

The environmental provision is related to a specific concern at the Company's Canadian subsidiary. Estimates related to the provision are based on a number of assumptions which are inherently difficult to determine and no assurances can be given that environmental test results, changes in laws or enforcement policies or other factors could not result in costs that differ from the estimates contained therein. As a result of the complexity of this matter, there have been changes in various estimates that resulted in multiple-year impacts. The provision for restructuring and severance costs is related to certain plans that require implementation over a period of time. The need for these plans is in response to the increasing costs at the Company's Canadian operations, principally driven by the strengthening of the Canadian dollar. Management does not consider these matters to be recurring in nature or part of the on-going business of the Company. The plant shutdown costs and related write-off of long-lived assets were a result of the closure of the chemical processing department in the Company's Cambridge, Ontario facility. The chemical processing department was closed to allow the Company to focus on its core business of manufacturing aerospace gears and transmissions.

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

RESULTS OF OPERATIONS

The following tables set forth information regarding the Company's operating performance for the three and nine months ended September 30, 2009 compared to the same periods ended September 30, 2008. This information should be read in conjunction with the unaudited consolidated interim financial statements of the Company and the related notes thereto.

Segment Revenue and Gross Margin Analysis

	Three months ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Revenues				
Defense	\$ 38,760	\$29,071	\$105,178	\$85,983
Commercial	9,338	10,954	35,024	34,134
Total Revenues	\$48,098	\$40,025	\$140,202	\$120,117
Gross Margin (% of Sales)				
Defense	23.7%	21.9%	22.3%	22.9%
Commercial	9.0%	6.7%	15.1%	10.6%
Total Gross Margin %	20.8%	17.7%	20.5%	19.4%

EBITDA from Continuing Operations

	Three months ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net (loss) income from continuing operations - as reported	\$ (411)	\$ 250	\$ 691	\$ 419
Adjustments:				
Income tax expense (recovery)	1,709	(752)	3,233	963
Adjusted net income (loss) from continuing operations before income taxes - comparable basis	1,298	(502)	3,924	1,382
% of Revenue	2.7%	-1.3%	2.8%	1.2%
Add:				
Depreciation and amortization	1,578	1,731	4,987	5,218
Amortization of revenue share agreement	539	1,010	3,667	2,876
Foreign exchange loss (gain)	338	(174)	554	(666)
Unusual items	-	-	(1,855)	-
Interest, net	1,949	1,561	4,858	4,764
Write off of deferred financing costs	-	-	309	-
(Gain) loss on interest rate swap contracts	(59)	24	1,045	85
EBITDA from continuing operations-comparable basis	\$ 5,643	\$ 3,650	\$ 17,489	\$ 13,659
% of Revenue	11.7%	9.1%	12.5%	11.4%

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009
(in thousands of U.S. dollars unless otherwise stated)

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 COMPARED TO 2008

Revenue from continuing operations for the three months ended September 30, 2009 was \$48,098, \$8,073 higher than the same period in 2008. Defense revenues were \$38,760 for the three months ended September 30, 2009, an increase of \$9,689 or 33.3% when compared to 2008 for the same period. This increase was mainly due to higher volumes on the CH-47 Chinook, F-22 and Sikorsky programs. Commercial revenues decreased \$1,616 or 14.8% to \$9,338 due primarily to lower CF34 volumes.

Revenue from continuing operations for the nine months ended September 30, 2009 was \$140,202, \$20,085 (16.7%) higher than the same period in 2008. Defense revenues were \$105,178 for the nine months ended September 30, 2009, an increase of \$19,195 or 22.3% compared to 2008 for the same period. This increase was mainly due to higher volumes on the CH-47 Chinook, F-22 and Apache programs. Commercial revenues increased \$890 or 2.6% to \$35,024 due largely to GEA's sales of spare parts inventory related to the CF-34-3 program that was held on consignment at GEA's locations. This was somewhat offset by lower volumes on programs with Honeywell and Sunstrand.

Gross margin from continuing operations, as a percentage of revenue, increased to 20.8% for the three months ended September 30, 2009 from 17.7% in 2008. Defense margin as a percentage of revenue was 23.7% in 2009, an increase from 21.9% in 2008 due to improved performance on the CH-47 and F-22 programs. The commercial gross margin percentage increased to 9.0% in 2009 compared to 6.7% in 2008 due to improved performance.

Gross margin from continuing operations, as a percentage of revenue, was 20.5% for the nine-month periods ended September 30, 2009 compared to 19.4% in 2008. Defense margin as a percentage of revenue was 22.3% in 2009, a decrease from 22.9% in 2008 mainly due to mix of work on the CH-47 and Apache programs. The commercial gross margin percentage was 15.1% in 2009 compared to 10.6% in 2008, mainly due to the sale of CF-34-3 inventory during the first quarter of 2009.

Selling, general and administrative ("SG&A") expenses were \$4,908, or 10.2% of revenue, in the three months ended September 30, 2009 compared to \$4,464, or 11.2% of revenue, in 2008. SG&A expenses were \$14,900 or 10.6% of revenue in the nine months ended September 30, 2009 compared to \$12,554, or 10.5% of revenue in 2008. The year-on-year increases in total dollars spent on SG&A for both the three-month and nine-month periods primarily resulted from adding depth to the management team to accommodate the increase in revenue projected for 2009.

Net interest expense was \$1,949 in the three months ended September 30, 2009 compared to \$1,561 in 2008 due to higher interest rates and payments on the interest rate swap contracts. Interest for the nine months ended September 30, 2009 was \$4,858 compared to \$4,764 for the same period in 2008 due to the same reason.

As of September 30, 2009, the Company has interest rate swap contracts totaling \$30,000 to manage the effect of changes in interest rates relating to variable-rate, long-term debt. These facilities have a fixed rate ranging from 4.86% to 5.58% plus the applicable margin, as defined in the credit agreement, with maturity dates ranging from July 2010 to March 2012.

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

In 2008, the Company had \$25,000 of interest rate swap contracts which qualified for hedge accounting. As such, the unrealized gain or loss on these contracts was included as a component of other comprehensive loss for the period.

With the amendment to the credit agreement in March 2009, the Company could no longer account for the \$25,000 of interest rate swap contracts as a cash flow hedge. Consequently, the accumulated unrealized loss of \$1,569 that had been recognized through other comprehensive income in prior periods up to December 31, 2008 was transferred to the Company's consolidated statement of operations during the first quarter of 2009. Accordingly, the Company now records the change in the fair value of all of the interest rate swap contracts in the statement of operations. The resulting charge was a \$59 gain and a \$1,045 loss for the three and nine months ended September 30, 2009, respectively compared to a \$24 and \$85 loss respectively in the same period last year. As of September 30, 2009 and December 31, 2008, a liability of \$2,738 and \$3,240, respectively, was included in other long-term liabilities related to outstanding contracts.

With the debt repayments in the three months ended June 30, 2009, the Company cancelled \$10,000 of the outstanding contracts to match the outstanding debt on the credit agreement of \$30,000 at June 30, 2009. The Company paid \$590 for cancellation of these contracts.

In January 2009, the Company sold its investment in Vector Aerospace Corporation ("Vector") for gross proceeds of approximately Cdn \$14,191 (3,638,750 common shares at Cdn \$3.90 per share) resulting in a gain of \$5,990. The accumulated unrealized gain, net of tax, of \$3,714 that had been recognized as other comprehensive income as of December 31, 2008 was transferred from accumulated other comprehensive income to the statement of operations in the first quarter of 2009.

The Company and Northstar Canada were defendants in a class proceeding in the Ontario Superior Court of Justice (Toronto) wherein the plaintiffs claimed damages for negligence, nuisance, breach of duty and related issues. In May 2009, the Company and Northstar Canada reached a settlement agreement with representatives of the class members. The settlement was approved by the Court in June 2009. Pursuant to the settlement agreement the class was certified for settlement purposes and the Company and Northstar Canada were to contribute Cdn \$5,050 towards two damages funds: one from which the class members' claims will be satisfied through a claims administration process, and a second from which class members' legal costs will be paid (the said Cdn \$5,050 being payable as follows: Cdn \$4,550 was paid in October 2009, \$1,550 in cash and \$3,000 by way of a promissory note payable no later than October 2012, and Cdn \$500 in March 2010). As part of the Court order approving the settlement, the class proceeding was dismissed. The Company recorded a provision of \$4,135 (Cdn \$5,050) as an unusual item in the interim consolidated statement of operations in the second quarter of 2009.

For the three and nine months ended September 30, 2009, the Company's income tax provision includes a tax expense of \$1,709 and \$3,233, respectively, related mainly to the U.S. continuing operations (2008 – \$752 recovery and \$963 expense, respectively). In the second quarter of 2009, the Company recorded a gain of \$5,990 (net of commissions and legal costs) related to the sale of its investment in Vector Aerospace Corporation. The tax provision related to this

MANAGEMENT DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2009

(in thousands of U.S. dollars unless otherwise stated)

gain was previously recorded in accumulated other comprehensive income and has been transferred to the statement of operations upon the sale of the investment. The Company had sufficient capital loss carry-forwards to offset the gain and accordingly, there are no current taxes payable. In the second quarter of 2009, the Company recorded a loss of \$2,039 on the sale of the net assets of TESG (Note 7). The tax benefit of \$752 related to this loss is reported in net loss, discontinued operations.

The future tax benefit of \$608 related to the interest rate swap contracts recognized in accumulated other comprehensive income at December 31, 2008 has also been transferred to the statement of operations during the nine month period ended September 30, 2009 since the related hedges are no longer effective. Additionally, the Company recorded operating income related to its Canadian operations. The related tax provision of \$400 was offset by a reduction to the valuation allowance against net operating losses carry-forward.

For the three and nine months ended September 30, 2009, as disclosed in the Company's 2008 annual report, the Company did not record a tax benefit for the losses generated from the Canadian operations and corporate costs. This benefit would have been approximately \$835 and \$2,535, respectively for the three and nine months ended September 30, 2009 to offset the net tax provision related to the U.S. operations.

Net loss from continuing operations was \$411 (\$0.01 per share) for the three months ended September 30, 2009 compared to income of \$250 (\$0.01 per share) in 2008.

Net income from continuing operations for the nine months ended September 30, 2009 was \$691 or \$0.02 per share compared to \$419 or \$0.01 per share in 2008. For the nine months ended September 30, 2009, the impact of the provision for the settlement agreement (\$4,135) and the change in accounting for the interest rate swap (\$882, net of tax) were offset by the gain on the sale of the investment in Vector Aerospace Corporation (\$5,256, net of tax).

In the fourth quarter of 2008, the Company announced plans to divest its repair and overhaul operation, Northstar Aerospace Turbine Engine Service Group, Inc. ("TESG") located in Stroud, Oklahoma, to focus on its core business of manufacturing gears and transmissions. Results from TESG were previously reported in the commercial market segment and are now reported as discontinued operations in the consolidated financial statement for all periods presented. On May 27, 2009, the Company completed the sale of certain net assets of TESG recognizing gross proceeds of \$9,447 including an adjustment for working capital of \$1,447 and a loss on the transaction of \$2,039 including transaction costs. Net loss from discontinued operations included in the consolidated financial statements for the three months ended September 30, 2008 was \$54. Net loss from discontinued operations for the nine months ended September 30, 2009 was \$852 compared to net income of \$594 for the same period in 2008.

MANAGEMENT DISCUSSION & ANALYSIS

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Including discontinued operations, net loss was \$411 (\$0.01 per share) for the three months ended September 30, 2009 compared to net income of \$304 (\$0.01 per share) in 2008. Net loss was \$161 (\$0.01 per share) for the nine months ended September 30, 2009 compared to net income of \$1,103 (\$0.03 per share) in 2008.

SUMMARY OF QUARTERLY INFORMATION

The following summarizes the Company's financial results from continuing operations over the past eight quarters (amounts in thousands of U.S. dollars except per share information):

	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007
Revenues	\$ 48,098	\$ 46,871	\$ 45,233	\$ 51,626	\$ 40,025	\$ 43,204	\$ 36,888	\$ 38,835
Gain (loss) from unusual items ⁽¹⁾	-	(4,135)	5,990	(1,632)	-	-	-	(6,386)
Net income (loss) ⁽²⁾	(411)	(5,187)	5,437	(10,427)	304	629	80	(7,709)
Income (loss) per share: basic & diluted ⁽²⁾	(0.01)	(0.17)	0.18	(0.35)	0.01	0.02	0.00	(0.27)

⁽¹⁾ includes environmental remediation and litigation provisions, restructuring charges for severance and termination, plant shut down costs and gain on sale of investments.

⁽²⁾ includes discontinued operations

LIQUIDITY AND CAPITAL RESOURCES

Total assets from continuing operations decreased \$9,844 in the nine-month period ending September 30, 2009 to \$146,393 at September 30, 2009, compared to \$156,237 at December 31, 2008.

Accounts receivable at September 30, 2009 decreased by \$5,833 since December 31, 2008 principally due to timing of shipments and collections in the period. Inventory increased by \$8,000 since December 31, 2008, due to increased production in anticipation of future shipments. Other current assets decreased \$11,066, mainly due to the sale of the Company's investment in Vector in January 2009.

Other long-term assets decreased \$1,334 in the nine months ended September 30, 2009 due to the amortization cost of rights and payments under the GEA Risk and Revenue Sharing Agreement.

At September 30, 2009, the Company had long-term debt (including current portion) of \$49,847, a \$20,529 decrease from December 31, 2008. Proceeds received from the sale of the Company's investment in Vector in January 2009, GEA's sale of CF34-3 inventory during the first quarter, and proceeds on the sale of the net assets of TEGS in May 2009 were used to repay long-term debt.

Cash used in operating activities from continuing operations was \$1,447 in the three months ended September 30, 2009 compared to cash provided of \$8,167 in 2008. For the nine-month

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period ended September 30, 2009 cash provided by operating activities from continuing operations was \$8,633 compared to \$11,946 for the same period in 2008. Improved collections on receivables offset by higher inventory were the main drivers behind the cash provided by operating activities.

Cash used in investing activities from continuing operations was \$260 in the three months ended September 30, 2009 compared to \$678 in 2008. The increase is mainly due to the sale of the net assets of TEGS in May 2009. Cash provided by investing activities from continuing operations for the nine months ended September 30, 2009 was \$16,069 compared to usage of \$1,900 in 2008. The increase is mainly due to the sale of the Company's investment in Vector in January 2009 and the sale of the net assets of TEGS in May 2009.

Cash provided by financing activities for continuing operations in the three months ended September 30, 2009 was \$1,707, compared to cash used of \$9,782 in 2008. Cash used in financing activities for continuing operations in the nine months ended September 30, 2009 was \$22,459, compared to \$11,077 in 2008. This was due to cash generated from operations and the sales of the Company's investment in Vector and the net assets of TEGS being used to pay down the credit facility. The Company also paid \$590 during the nine months ended September 30, 2009 to settle \$10,000 of interest rate swap contracts. In addition, \$383 of financing fees for the March 2009 amendment to the credit facility were incurred in the nine months ended September 30, 2009.

As of September 30, 2009, the Company has a \$50,000 revolving credit line available with unused borrowing capacity of \$9,540 available after netting approximately \$4,782 of committed letters of credit, which are mainly required by certain provisions of the Company's pension plans and related to the TEGS transaction.

As of December 31, 2008, the Company had a \$60,000 revolving credit line and a \$15,000 term loan under the same credit facility. The Company obtained an amendment at December 31, 2008 that resolved a covenant violation from September 30, 2008, reset the financial covenants required for December 31, 2008, and required that the Company pay down the borrowings on the credit facility by \$25,000 by April 30, 2009. During the nine months ended September 30, 2009, the Company paid down \$24,895 of the credit facility including \$15,000 of the term loan and \$9,895 of the revolving credit line through proceeds from the sales of the investment in Vector and the net assets of the TEGS business and certain consigned inventory that was sold in connection with GEA's sale of its spare parts business.

In March 2009, the Company obtained an amendment to its bank agreement that waived covenant violations at December 31, 2008 and adjusted the remaining requirement to pay down debt by \$8,285 by April 30, 2009 to \$7,500 by July 31, 2009. As part of this amendment the Company's interest rate on outstanding borrowings was increased to an adjusted base rate, as defined in the amended credit agreement, plus 4.50% or the London Interbank Offered Rate plus 4.75%. The fee for letters of credit was increased from 1.0% to 4.75%. The Company paid additional fees of \$383 for the March 2009 amendment. The maturity of the credit agreement was moved from March 2012 to October 2010.

Additionally, the Company has an equipment lease line of credit to fund capital expenditures required for expansion of the Company's production capacity. There were no additional

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borrowings on the equipment line of credit during the three months ended September 30, 2009. During the three months ended September 30, 2008, the Company drew \$73 on the equipment line of credit to finance capital expenditures for continuing operations. During the nine months ended September 30, 2009 and 2008, the Company drew \$569 and \$2,528, respectively, on the equipment line of credit to finance capital expenditures for continuing operations.

OUTLOOK

Management's concentration on improving the Company's balance sheet has resulted in over \$20,000 reduction in long-term debt in 2009. A similar focus on resolving legacy issues has resulted in the recent class action settlement which helps to reduce future uncertainty. Company-wide focus on achieving operational plans is also producing results evidenced by increasing deliveries and associated revenue growth. Management will continue its focus on progress in these areas of the business.

Revenue in the defense sector is expected to remain strong for the balance of 2009 and into 2010. The balance of 2009 is also expected to benefit from the delivery of new build transmissions on the AH-64 Apache helicopter and an increase in activity with Sikorsky. The anticipated increase in revenue will be somewhat tempered because a significant amount of production resources will be dedicated to the Block III upgrade of the Apache helicopter. The Block III upgrade is a development program and the production is reported net against reimbursement under the development contract rather than as revenue. The Block III program offers longer-term potential for the company as more than 600 AH-64 Apache helicopters are slated to be upgraded using an innovative transmission featuring Face Gear technology. The Company holds a patent on Face Gear manufacturing processes.

Revenue in the commercial sector received a benefit in activity in the first three months of 2009 as GEA entered into a distribution agreement with Aviall for its spare parts business on the CF34-3 program. The benefit resulted from the sale to Aviall of consigned inventory held at GEA. The benefit of this sale offset a general downturn in commercial sector activity. Management is cautious about expectations for future periods in the commercial sector as orders for new build engines are continuing to be deferred and forecasts are being reduced.

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RISKS AND UNCERTAINTIES

The Company's risks and uncertainties are disclosed in the MD&A section of the Company's 2008 Annual Report. In 2009, the Company is subject to increased risk and uncertainty related to the credit market, particularly as a result of the covenant violation described in the Liquidity and Capital Resources section in this MD&A.

The Company had previously been served with six individual actions related to operations at Northstar Aerospace Turbine Engine Service Group, Inc. in Stroud, Oklahoma. Each action names in excess of 10 defendants and seeks damages (in undetermined amounts and including punitive damages) for alleged acts of negligence that resulted in wrongful death in connection with an aircraft crash on or about July 29, 2006 during a skydiving expedition near Sullivan, Missouri. The Company was released without prejudice from each of the six actions in February and March 2009. In July 2009, the Company received notice of an additional claim related to this matter. This incident is fully insured and the Company's insurance provider is defending the action. The Company and its insurance provider are seeking a similar release as was received on the other six actions.

OFF BALANCE SHEET ARRANGEMENTS AND FINANCIAL INSTRUMENTS

The Company's off balance sheet arrangements include operating leases and commitments, defined benefit pension and post-retirement benefit funding obligations and bank issued letters of credit. The Company's financial instruments include accounts receivable, accounts payable, long-term debt and interest rate swap contracts. With the exception of the post-retirement benefit funding obligations, off balance sheet arrangements and financial instruments have not changed materially from December 31, 2008. At December 31, 2008, the Company identified errors in accounting for contribution payments the Company made to fund its pension plan obligations prior to 2008. This funding reduced the value of the letters of credit required to support the unfunded liabilities of these plans in 2009.

TRANSACTIONS WITH RELATED PARTIES

The Company has not entered into any material transactions with related parties as defined in the Canadian Institute of Chartered Accountants Handbook during the nine months ended September 30, 2009.

PROPOSED TRANSACTIONS

There are no proposed transactions of any significance that are expected to have an effect on the financial position or results of operations of the Company.

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DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

In connection with the accounting for progress billing on long-term contracts, management concluded it did not maintain an effective design of internal controls over financial reporting as a reconciliation process was not in place to identify payments that may be received in advance of meeting the prescribed milestones. This control deficiency resulted in a restatement to increase inventory and other current liabilities by \$14,984 for the advance payments received as of December 31, 2008. A reconciliation has been prepared for the balances as of September 30, 2009 and December 31, 2008 and a process has been implemented to prepare the reconciliation on a quarterly basis going forward.

There have been no other material changes in the Company's internal control over financial reporting during the nine months ended September 30, 2009 that have affected, or are reasonably likely to affect, the Company's internal control over financial reporting.

OTHER MD&A REQUIREMENTS

Additional Information

An Annual Information Form ("AIF") is prepared annually by the Company and filed on SEDAR at www.sedar.com.

Outstanding Share Data

The authorized share capital of the Company consists of an unlimited number of preference shares of no par value to be issued in series and an unlimited number of common shares of no par value. As at September 30, 2009 and November 5, 2009, there were 29,880,318 common shares outstanding and no preference shares outstanding.

At September 30, 2009, there were 1,577,000 (December 31, 2008 – 1,634,000) options outstanding. During the nine months ended September 30, 2009, 57,000 (2008 – 363,000) options expired or were cancelled.